In the Supreme Court of the United States

OCTOBER TERM, 1974

No. 74-1138

ROLAND J. KALB AND JEROME L. HEROLD, PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

Petitioners challenge the correctness of the decision below holding that one of them was personally liable for withholding taxes under Section 6672 of the Internal Revenue Code of 1954 because he willfully failed to pay such taxes after he had withheld them from employees' wages.[1]

The pertinent facts are as follows: During 1959 through 1961, petitioners were officers and directors of Herold Radio & Electronics Company (Pet. App. C 33a-34a; I-R. 103a).[2] Kalb was the chairman of the board and chief executive officer and Herold was the president of the company (Pet. App. C 33a-34a; I-R. 103a, 186a; II-R. 472a).

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[1]The court of appeals reversed the judgment of the district court with respect to petitioner Herold and remanded the case to the district court to determine whether Herold's failure to pay over withheld taxes was willful. It would therefore appear that the petition is premature as to Herold.

[2]References to "I-R." and "II-R." are to the two-volume record filed in the court of appeals.

In 1959, the company encountered financial difficulties, and the bank which had supplied the company with financing threatened to withdraw its line of credit. An agreement was reached in which the bank would continue the line of credit on the condition that the bank be permitted to place a representative on the company's premises to oversee the company's financial operations. During the period the bank's representative was on the premises, payments were made only to the company's most persistent creditors and, although the company continued to withhold taxes, these taxes were not paid over to the government. Efforts to improve the company's deteriorating financial condition were not fruitful. When the company ceased operations in 1961, its withholding taxes were still unpaid (Pet. App. C 27a; II-R. 749a).

In April, 1969, pursuant to Section 6672, the Internal Revenue Service assessed $163,613.35 in penalties against each of the petitioners on the ground that each was a person required to collect and pay over withholding taxes who had willfully failed to do so with respect to wages of employees of the company for various periods during 1959, 1960 and 1961 (Pet. App. C 26a; II-R. 748a). Kalb paid part of the assessment and then commenced this refund suit, and the government counterclaimed for the balance of the assessment and filed a third-party complaint against Herold. Herold also paid part of the assessment and then counterclaimed for his partial payment. The district court, after the presentation of evidence to the jury, dismissed Kalb's claim and Herold's counterclaim and directed a verdict for the United States on its counterclaim and third-party claim (Pet. App. C 26a). The court of appeals affirmed the district court's judgment as to Kalb. However, the court of appeals, while affirming that Herold was responsible for the collection and payment of withholding taxes, re-

versed the judgment and remanded the case for a determination whether Herold's failure to pay over the taxes was willful under Section 6672.

1. Although petitioners argue (Pet. 10-11) that they were deprived of their right to a jury trial under the Seventh Amendment, they did in fact have a jury trial. Here, the district court directed a verdict for the government on the basis of its view that, on the evidence and in light of the applicable legal principles, the jury could not return a verdict for petitioners. That action was an appropriate exercise of the court's authority, in order to insure that the jury consider only disputed issues of fact. See *Galloway* v. *United States*, 319 U.S. 372, 396. The correctness of the trial court's view that the evidence could not support a verdict for petitioners is not an appropriate matter for review by this Court. *Comstock* v. *Group of Investors*, 335 U.S. 211, 214.

2. Petitioners further contend (Pet. 13) that their withholding tax liability should have been eliminated because they had directed that an income tax overpayment made in connection with the corporation's 1960 tax year be applied against the deficiency in withholding taxes and that the government had no right to apply it instead to other excise tax liabilities of the corporation. But Section 6402(a) of the Code provides that the Commissioner may credit an overpayment to any tax liability of the overpayor. 10 Mertens, *Law of Federal Income Taxation* (1970 rev.), Section 58.27, relied upon by petitioners (Pet. 13), does not support their position since it deals with funds voluntarily paid and not with the application of overpayments by a taxpayer. Indeed, the pertinent reference in Mertens, *supra*, at Section 58.38, which deals with the crediting of overpayments, states that the Commissioner may credit an overpayment as he sees fit.

Even if the Commissioner was not bound to apply the overpayment as directed by petitioners, they argue (Pet. 11-13) that their belief, on advice of counsel, that it would be so applied, removed the element of willfulness from their failure to pay over the withholding taxes. They urge that *Gray Line Co.* v. *Granquist*, 237 F.2d 390 (C.A. 9), certiorari denied, 353 U.S. 911, where the responsible officer was held not liable under Section 6672 because of reliance upon advice of counsel that certain transportation taxes were not owed to the government, is in conflict with the decision below.

Apart from the fact that petitioners introduced no evidence to support the contention that they received such legal advice, petitioners' failure to collect and pay over the withholding taxes could not possibly have rested upon any expectation that the government would honor the request as to application of the overpayment. By letter dated August 9, 1960 (II-R. 760a) the corporation requested the Internal Revenue Service to use the overpayment first to pay already existing withholding tax deficiencies and to apply the balance against its excise tax liabilities, which were also overdue as of that date. But petitioners' failure to pay over the withholding taxes referred to in the letter had occurred prior to the discovery of the overpayment and the August 9, 1960, request. Petitioners' failure to pay the withholding taxes was either willful or not at the time the default occurred.

Thus, the after-discovered availability of the overpayment cannot alter the fact that the original default was the result of petitioners' willful failure to discharge their duties as responsible persons. At all events, petitioners cannot seriously claim reliance upon the overpayment with respect to withholding taxes required to be collected and paid

over after August 9, 1960, since the express direction in the letter of that date was to use any balance to pay excise taxes of their corporation. Hence, *Gray Line* is distinguishable on its facts.[3]

3. Contrary to petitioners' assertion (Pet. 13-16), the liability that Section 6672 imposes is not criminal (although the statute uses the term "penalty"). It provides for civil recovery by the government, from the person upon whom the statute imposes a fiduciary responsibility, of amounts which should have been paid over to the government and which it lost through that person's willful breaching of his fiduciary duties. *Monday* v. *United States*, 421 F.2d 1210 (C.A. 7), certiorari denied, 400 U.S. 821; *Braden* v. *United States*, 442 F.2d 342 (C.A. 6), certiorari denied *sub nom. Bonistall* v. *Braden*, 404 U.S. 912; *Cash* v. *Campbell*, 346 F.2d 670 (C.A. 5); *United States* v. *Molitor*, 337 F.2d 917 (C.A. 9); *Botta* v. *Scanlon*, 314 F.2d 392 (C.A. 2).[4]

4. Finally, petitioners urge (Pet. 16-18) that the assessment procedure applied in this case is unconstitutional. Section 6671(a) (26 U.S.C.) provides that the penalties provided by Subchapter B (including Section 6672) "shall be assessed and collected in the same manner as taxes." It has long been settled that collection of taxes by summary administrative proceedings prior to hearing does not violate the taxpayer's right to due process, as long as there is a post-seizure opportunity for a judicial hearing. *Phillips*

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[3]In *Haywood Lumber and Mining Co.* v. *Commissioner*, 178 F.2d 769 (C.A. 2) (Pet. 13), the issue was whether there was reasonable cause for the taxpayer's failure to file certain required reports. Taxpayer's accountant had provided the assistance before the acts in question and the reporting failures were found to have been directly attributable to the negligence of the accountant.

[4]That the penalty is not criminal is amply evidenced by the fact that it is applied only to the extent of the government's loss. See *Monday* v. *United States, supra*; *Newsome* v. *United States*, 431 F.2d 742 (C.A. 5).

v. *Commissioner*, 283 U.S. 589. See also *Fuentes* v. *Shevin*, 407 U.S. 67, 91-92. This proceeding provided just such a post-seizure judicial hearing.

For the reasons stated, it is respectfully submitted that the petition for a writ of certiorari should be denied.

ROBERT H. BORK,
Solicitor General.

APRIL 1975.